

## Power of Government Purchases

Every year USDA's Commodity Credit Corporation (CCC) purchases millions of pounds of cheese for food distribution programs, such as school lunch and breakfast programs and commodity distribution programs. These purchases support dairy commodity



prices. During periods of surplus dairy product production, the CCC has historically acquired cheese, butter, and nonfat dry milk through the price support program. However, for more than a decade, the CCC has made commercial purchases of dairy products to supply food distribution programs.

*Much of the Mozzarella cheese purchased by the CCC is used as an ingredient for pizzas consumed in the school lunch program*

It is not surprising that CCC purchases are heavily weighted to the school year. From October 2010 through May 2011, the CCC purchased 106 million pounds of cheese. American-style cheese represented approximately 56% of total purchases while Mozzarella accounted for the other 44%. Much of the Mozzarella cheese purchased by the CCC is used as an ingredient for pizzas consumed in the school

lunch program.

The chart below illustrates American and Mozzarella cheese deliveries by month. Deliveries of American cheese are typically close to 10 million pounds during the last quarter of the year. More than 80% of the American

cheese purchased during Q4 2010 was in the form of either processed or 500-lb. barrel cheese, and the pricing of these products is tied to the Chicago Mercantile Exchange (CME) barrel cheese price.

While actual CCC purchase volumes for Q4 2011 will not be available until 2012, CCC purchases during the October through May time frame have been fairly consistent year to year. This year, government purchases

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### Ken's Corner



*by Ken Meyers  
President, MCT Dairies Inc.*

With government purchases of cheese starting to pick up seasonally and cheese production still lower than the previous year, the outlook for cheese prices remains strong but tenuous.

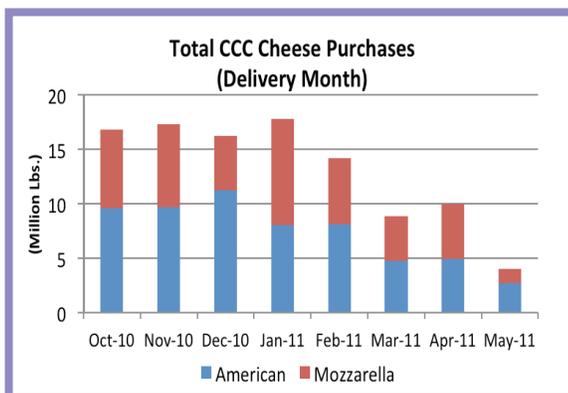
USDA is predicting lower average cheese prices in 2012. USDA expects 2011 prices to average near \$1.83, with average cheese prices next year about a dime lower.

The major downside risk for world cheese demand continues to be Europe's inability to solve its sovereign debt crisis. If European financial markets seize up, the impact will be felt from here to China.

On the upside, though, is the recently approved South Korea-United States Free Trade Agreement. In the first nine months of this year, U.S. cheese exports to South Korea more than doubled to 28,511 tons (62.9 million pounds), compared with the same period a year earlier. The United States is now the top supplier of cheese to South Korea, with 45% of the country's market.

Under the agreement, the United States will be given unprecedented duty-free access for feed-grade whey and for 16,000 tons of cheese, milk powders, food-grade whey, and other products. Most of Korea's remaining tariffs will be phased out over 5-10 years.

Regardless of which way 2012 swings, the long-term outlook for dairy remains bright. **MCT**



# Balancing Act...

After trading at higher levels through the year, dairy product markets are adjusting to a new

market equilibrium. U.S. dairy producers are likely to respond to strong mailbox prices in

December 2011 and January 2012, which could set the stage for downward price pressure in early 2012. Looking longer term, though, producers are expected to respond more quickly than usual to market signals to bring supply back into balance with demand given the tight profitability on farms. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Nov	1.8719	1.8955	19.10	1.7265	17.95	0.6400	1.4625
Dec	1.7375	1.7050	19.00	1.6025	16.85	0.6500	1.4250
Jan	1.6650	1.6450	18.00	1.5975	16.30	0.6550	1.3800
Feb	1.6175	1.5975	17.05	1.6075	16.10	0.6350	1.3500
Mar	1.6300	1.6100	16.85	1.6500	16.05	0.6100	1.3200
Apr	1.6350	1.6150	16.90	1.6750	16.00	0.6000	1.3050

\* CME prices.

\*\*NASS prices.

## Lagging production...

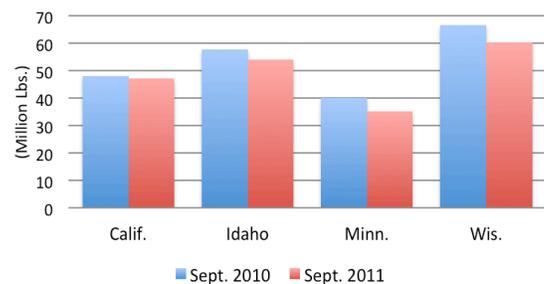
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coupled with lower American cheese production have likely contributed to the overall strength of the CME barrel cheese market.

Since July 2011, total cheese production has lagged the prior year due to lower American and Mozzarella production. American cheese production was unchanged in September 2011 vs. the prior month but down a staggering 4.2% vs. September 2010. American cheese production during Q1 2011 was up 1.9% compared with the prior year. Since then, production has trailed year-earlier levels. Year-over-year declines in American cheese production accelerated after hot, humid weather across the Midwest reduced milk production this past summer.

The chart to the right illustrates that American cheese production decreased in each of the key cheese-producing states during September 2011, compared with the prior year, for a total drop of 15.7 million pounds. Year to date, Cheddar cheese production in Minnesota is down 20.8 million pounds vs. the comparable period in 2010. American-style cheese production in Wisconsin is 65 million pounds

U.S. American/Cheddar Cheese Production (Sept. 2011 vs. Sept. 2010)



lower year to date, compared with the same period a year earlier. As a result, Midwest manufacturers with government contracts to deliver barrel and processed cheese in November and December appeared to be searching for more product on the spot market or moving spot prices higher to entice greater barrel cheese production and ration demand.

From mid-October to mid-November, the CME barrel price increased 35 cents from \$1.70/lb. to \$2.05/lb. Since then, the barrel market has retreated to \$1.72/lb. Nevertheless, the November CME barrel cheese price will average near \$1.90/lb.—the second highest November CME barrel cheese price of the past decade. **MCT**



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